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Price Waterhouse LLP

Report of Independent Accountants on Compliance

To the Board of Governors of the
Federal Reserve System

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the Board) as of and for the year ended December 31, 1996, and have issued our report thereon dated March 25, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the Board is the responsibility of the Board's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Board's compliance with certain provisions of laws and regulations. However, providing an opinion on overall compliance with such provisions was not the objective of our audit of the financial statements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

This report is intended for the information of the Board. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse LLP

March 25, 1997
Arlington, Virginia

1616 North Fort Myer Drive
Arlington, VA 22209-3195

Telephone 703 741 1000
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Price Waterhouse LLP

Report of Independent Accountants on Internal Controls

To the Board of Governors of the
Federal Reserve System

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the Board) as of and for the year ended December 31, 1996, and have issued our report thereon dated March 25, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Board is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Board for the year ended December 31, 1996, we obtained an understanding of the internal controls. With respect to the internal controls, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal controls. Accordingly, we do not express such an opinion.

Our consideration of the internal controls would not necessarily disclose all matters in the internal controls that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls and their operation that we consider to be material weaknesses as defined above.

This report is intended for the information of the Board. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse LLP

March 25, 1997
Arlington, Virginia

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Arlington, VA 22209-3195

Telephone 703 741 1000
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Price Waterhouse LLP

Report of Independent Accountants on Compliance

To the Board of Governors of the
Federal Reserve System

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the Board) as of and for the year ended December 31, 1996, and have issued our report thereon dated March 25, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the Board is the responsibility of the Board's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Board's compliance with certain provisions of laws and regulations. However, providing an opinion on overall compliance with such provisions was not the objective of our audit of the financial statements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

This report is intended for the information of the Board. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse LLP

March 25, 1997
Arlington, Virginia

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

FINANCIAL STATEMENTS AND FINANCIAL AUDIT REPORTS

as of and for the years ended December 31, 1996 and 1995

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Section	Description
I	Report of Independent Accountants and Financial Statements
II	Report of Independent Accountants on Internal Controls
III	Report of Independent Accountants on Compliance

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEET

ASSETS

	As of December 31, 1996	As of December 31, 1995
CURRENT ASSETS		
Cash	$ 15,712,258	$16,142,195
Accounts receivable	2,561,975	1,900,155
Transfers receivable--surplus Federal Reserve Bank earnings (Note 1)	659,862,602	--
Prepaid expenses and other assets	2,247,391	1,225,022
Total current assets	680,384,226	19,267,372
PROPERTY, BUILDINGS AND EQUIPMENT, NET (Note 4)	61,110,184	59,781,623
Total assets	$741,494,410	$79,048,995

LIABILITIES AND FUND BALANCE

	1996	1995
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 10,435,545	$ 7,580,371
Accrued payroll and related taxes	6,804,678	4,868,497
Transfers payable--surplus Federal Reserve Bank earnings (Note 1)	659,862,602	--
Accrued annual leave	6,966,327	6,601,004
Capital lease payable (current portion)	--	75,840
Unearned revenues and other liabilities	2,263,338	2,184,882
Total current liabilities	686,332,490	21,310,594
CAPITAL LEASE PAYABLE (non-current portion)	--	232,638
ACCUMULATED RETIREMENT BENEFIT OBLIGATION (Note 2)	466,056	--
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3)	18,171,722	17,074,588
ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 3)	1,409,343	1,093,400
FUND BALANCE	35,114,799	39,337,775
Total liabilities and fund balance	$741,494,410	$79,048,995

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
STATEMENT OF REVENUES AND EXPENSES
AND FUND BALANCE

	For the years ended December 31, 1996	1995
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$ 162,642,400	$161,347,900
Other revenues (Note 5)	9,789,141	10,240,830
Total operating revenues	172,431,541	171,588,730
BOARD OPERATING EXPENSES		
Salaries	106,353,644	100,412,576
Retirement and insurance contributions	18,417,943	16,394,955
Contractual services and professional fees	11,159,490	11,240,373
Depreciation and net losses on disposals	8,626,785	7,525,971
Travel	4,942,020	4,920,996
Equipment and facilities rental	4,356,715	3,853,657
Postage and supplies	4,263,382	4,523,272
Utilities	4,189,203	4,155,038
Software	3,907,874	3,362,342
Repairs and maintenance	3,417,539	3,689,603
Printing and binding	2,665,188	3,144,178
Other expenses (Note 5)	4,354,734	3,915,489
Total operating expenses	176,654,517	167,138,450
BOARD OPERATING REVENUES (UNDER) OVER EXPENSES	(4,222,976)	4,450,280
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	403,232,215	370,206,037
Expenses for currency printing, issuance, retirement and shipping	403,232,215	370,206,037
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	--	--
TOTAL REVENUES (UNDER) OVER EXPENSES	(4,222,976)	4,450,280
FUND BALANCE, Beginning of year	39,337,775	34,887,495
TRANSFERS TO THE U. S. TREASURY		
Transfers and accrued transfers from surplus Federal Reserve Bank earnings (Note 1)	5,623,716,034	--
Transfers and accrued transfers to the U. S. Treasury (Note 1)	(5,623,716,034)	--
FUND BALANCE, End of year	$ 35,114,799	$ 39,337,775

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF CASH FLOWS

Increase (Decrease) in Cash

	For the years ended December 31, 1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES		
Board operating revenues (under) over expenses	$ (4,222,976)	$ 4,450,280
Adjustments to reconcile operating revenues (under) over expenses to net cash provided by operating activities:		
Depreciation and net losses on disposals	8,626,785	7,525,971
(Increase) in transfers receivable--surplus Federal Reserve Bank earnings	(659,862,602)	--
Increase in accumulated postretirement benefits	1,097,134	800,142
Increase in accumulated retirement benefits	466,056	--
Increase (decrease) in accumulated postemployment benefits	315,943	(226,618)
(Increase) decrease in accounts receivable, prepaid expenses and other assets	(1,684,189)	438,229
Increase in accrued annual leave	365,323	377,085
Increase in accounts payable and accrued liabilities	2,855,174	2,129,494
Increase in transfers payable--surplus Federal Reserve Bank earnings	659,862,602	--
Increase in payroll payable and related taxes	1,936,181	948,432
Increase in unearned revenues and other liabilities	78,456	332,268
Net cash provided by operating activities	9,833,887	16,775,283
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals of furniture and equipment	70,500	12,112
Capital expenditures	(10,334,324)	(15,594,485)
Net cash used in investing activities	(10,263,824)	(15,582,373)
NET (DECREASE) INCREASE IN CASH	(429,937)	1,192,910
CASH BALANCE, Beginning of year	16,142,195	14,949,285
CASH BALANCE, End of year	$ 15,712,258	$16,142,195

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

(1) SIGNIFICANT ACCOUNTING POLICIES

Board Operating Revenues and Expenses--Assessments made on the Federal Reserve Banks for Board operating expenses and capital expenditures are calculated based on expected cash needs. These assessments, other operating revenues, and operating expenses are recorded on the accrual basis of accounting.

Issuance and Redemption of Federal Reserve Notes--The Board incurs expenses and assesses the Federal Reserve Banks for the costs of printing, issuing, shipping, and retiring Federal Reserve Notes. These assessments and expenses are separately reported in the statements of revenues and expenses because they are not Board operating transactions.

Property, Buildings and Equipment--The Board's property, buildings and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 4 to 10 years for furniture and equipment and from 10 to 50 years for building equipment and structures. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is recognized.

Federal Reserve Bank Surplus Earnings--The Omnibus Budget Reconciliation Act of 1993 requires that surplus Federal Reserve Bank earnings be transferred from the Banks to the Board and then to the U. S. Treasury for the period October 1, 1996 to September 30, 1998. Prior to this time the Federal Reserve Banks made their transfers directly to the Treasury. The Board accounts for these transfers when earned and due, which may result in transfers receivable and payable as of the balance sheet date.

Estimates--The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

Reclassifications--Certain 1995 disclosures have been reclassified to conform with the 1996 presentation, the effect of which is immaterial.

(2) RETIREMENT BENEFITS

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System Plan is a multiemployer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office. Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the System Plan. Contributions to the System Plan are actuarially determined and funded by participating employers at amounts prescribed by the System Plan's administrator. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 1996 and 1995, and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions. The Board is not accountable for the assets of this plan.

A small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The Board matches employee contributions to these plans. These defined benefit plans are administered by the Office of Personnel Management. The Board's contributions to these plans totalled $201,500 and $802,200 in 1996 and 1995, respectively. The Board has no liability for future payments to retirees under these programs, and it is not accountable for the assets of the plans.

Effective January 1, 1996, Board employee's covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan due to limitations imposed by Sections 401(a)(17), 415(b) and 415(e) of the Internal Revenue Code of 1986. Pension costs attributed to the BEP reduce the pension costs of the System Plan. The net periodic pension cost for the BEP for 1996 included the following components:

Service cost (benefits attributed to employee services during the year)	$260,868
Interest cost on projected benefit obligation	102,594
Amortization of unrecognized net liability	102,594
Net periodic pension cost	$466,056

Although these pension costs are recorded using the accrual basis of accounting in accordance with Statement of Financial Accounting Standards No.87, "Employers' Accounting for Pensions" (FAS 87), the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The net periodic pension cost was determined using a 7.0 percent discount rate and average compensation growth of 5 percent.

The FAS 87 accumulated benefit obligation at December 31, 1996, comprises:

Accumulated benefit obligation	
Vested	$ 218,000
Nonvested	21,000
Total	$ 239,000
Plan assets at fair value	$ -0-
Less: Actuarial present value of projected benefit obligation	(1,589,924)
Projected benefit obligation in excess of plan assets	(1,589,924)
Less: Unrecognized net transition obligation	1,363,041
Unrecognized prior service cost	(190,000)
Unrecognized net (gain)	(49,173)
Unfunded pension cost	$ (466,056)

The liability as of December 31, 1996, was determined using a 7.25 percent discount rate. The average rate of compensation increase used was 5 percent a year. The Board has elected to amortize the unrecognized prior service cost over 14.3 years.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

(3) OTHER BENEFIT PLANS

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Under the Thrift Plan, members may contribute up to a fixed percentage of their salary. Board contributions are based upon a fixed percentage of each member's basic contribution and were $4,644,100 in 1996 and $4,320,400 in 1995.

The Board also provides certain defined benefit health and life insurance for its active employees and retirees under Federal and Board sponsored programs. The net periodic postretirement benefit cost for 1996 and 1995 included the following components:

	1996	1995
Service cost (benefits attributed to employee services during the year)	$ 195,016	$ 418,649
Interest cost on accumulated postretirement benefit obligation	1,461,103	1,441,350
Amortization of (gains) and losses	372,253	(80)
Net periodic postretirement benefit cost	$2,028,372	$1,859,919

Although postretirement benefits are recorded using the accrual basis of accounting in accordance with FAS 106, the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The FAS 106 accumulated postretirement benefit obligation at December 31, 1996 and 1995, comprises:

	1996	1995 (reclassified)
Retirees	$14,393,309	$14,061,087
Fully eligible active plan participants	3,512,825	3,528,612
Other active plan participants	3,422,992	3,773,612
	21,329,126	21,363,311
Unrecognized net loss	(3,157,404)	(4,288,723)
Liability for accumulated postretirement benefit obligation	$18,171,722	$17,074,588

The liability for the accumulated postretirement benefit obligation and the net periodic benefit cost were determined using a 7.25 percent discount rate. Unrecognized losses of $3,157,404 result from changes in the discount rate used to measure the liabilities. Under FAS 106, the Board may have to record some of these unrecognized losses in operations in future years. The assumed health care cost trend rate for measuring the increase in costs from 1996 to 1997 was 9.5 percent. These rates were assumed to gradually decline to an ultimate rate of 5.5 percent in the year 2005 for the purpose of calculating the December 31, 1996, accumulated postretirement benefit obligation. The effect of a 1-percent increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation by $2,543,145 at December 31, 1996, and the net periodic benefit cost by $184,055 for the year. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 5 percent.

The above accumulated postretirement benefit obligation is related to the Board sponsored health benefits and life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored programs upon retiring. Contributions for active employees participating in federally sponsored programs totalled $3,553,400 and $3,477,300 in 1996 and 1995, respectively.

The Board provides certain postemployment benefits to eligible employees after employment but before retirement. Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, Employers' Accounting for Postemployment Benefits (FAS 112), which requires that employers providing postemployment benefits to their employees accrue the cost of such benefits. Prior to January 1994, postemployment benefit expenses were recognized on a pay-as-you-go basis.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

(4) PROPERTY, BUILDINGS AND EQUIPMENT

The following is a summary of the components of the Board's fixed assets, at cost, net of accumulated depreciation.

	As of December 31,	
	1996	1995
Land and improvements	$ 1,301,314	$ 1,301,314
Buildings	65,343,600	65,298,136
Furniture and equipment	54,592,393	52,215,976
	121,237,307	118,815,426
Less accumulated depreciation	60,127,123	59,033,803
Total property, buildings and equipment	$ 61,110,184	$ 59,781,623

(5) OTHER REVENUES AND OTHER EXPENSES

The following are summaries of the components of Other Revenues and Other Expenses.

	For the years ended December 31,	
	1996	1995
Other Revenues		
Data processing revenue	$4,612,476	$4,100,517
National Information Center	1,974,295	2,070,267
Subscription revenue	1,583,193	1,648,931
Reimbursable services to other agencies	424,940	383,752
Miscellaneous	1,194,237	2,037,363
Total other revenues	$9,789,141	$10,240,830

	For the years ended December 31,	
	1996	1995
Other Expenses		
Tuition, registration and membership fees	$1,290,090	$1,413,233
Cafeteria operations, net	870,429	788,506
Subsidies and contributions	646,194	755,857
Miscellaneous	1,548,021	957,893
Total other expenses	$4,354,734	$3,915,489

(6) COMMITMENTS

The Board has entered into several operating leases to secure office, training and warehouse space for periods ranging from one to nine years. Minimum future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1996, are as follows:

1997	$ 3,724,037
1998	3,645,048
1999	3,681,559
2000	3,938,055
after 2000	17,121,831
	$32,110,530

Rental expenses under the operating leases were $3,930,689 and $3,301,186 in 1996 and 1995, respectively.

(7) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1996 and 1995, the Board paid $224,600 and $269,040, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1996 and 1995. During 1996 and 1995, the Board paid $127,100 and $126,900, respectively, for office space sub-leased from the Council.